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UNITED STATES OF AMERICA

SUPREME COURT OF THE UNITED STATES

October 1931 Term

PEOPLE OF THE STATE OF MICHIGAN, By John S. Haggerty, Secretary of State,
Petitioner,

vs.

MICHIGAN TRUST COMPANY, Receiver of Worden Grocer Company,
Respondent.

No. 598.

BRIEF OF THE PEOPLE OF THE STATE OF MICHIGAN.

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BRIEF OF THE PEOPLE OF THE STATE OF MICHIGAN.

On February 15, 1932, this Court granted the petition for a writ of certiorari in the above cause, to review the decision of the Circuit Court of Appeals—Sixth Circuit —(R. 34) reversing the decision of the District Court (R. 16), which had ordered the receiver of a Michigan corporation to pay the state corporation privilege fee, which accrued after the receiver had been appointed.

FACTS

The Woolson Spice Company, an Ohio corporation, on February 9, 1926, petitioned the District Court of the United States, Western District of Michigan, for the ap-

pointment of a receiver for the Worden Grocer Company, a Michigan corporation, then engaged in the wholesale grocery business (R. 2), alleging that the Worden Grocer Company was indebted to it in the sum of $3,344.14 (R. 2); that the Worden Grocer Company was then engaging in the real estate business through a subsidiary company known as the Worden Realty Company (R. 3); that because preferred stockholders of the Worden Grocer Company were demanding payment of their stock, and by reason of the inability of the Realty Company to retire the mortgage given at the time a bond issue was floated by the Realty Company, the petitioner, the Woolson Spice Company, feared that its account would not be paid (R. 3). It alleged that while the grocery company was solvent (R. 4) it feared the business would suffer, because of threatened suits to force the payment of other claims, and by reason of the foreclosure of said mortgage (R. 5); that the interests of the creditors and stockholders would be "best subserved if a receiver be appointed to take charge of the properties and business of the Worden Grocer Company, and with power to borrow moneys wherewith to operate the business thereof, and to protect the right of the Worden Grocer Company to occupy the real property at the City of Grand Rapids, owned by Worden Realty Company, and for such other purposes as may be necessary in order to avoid sacrifice and waste of the corporate assets" (R. 6). It prayed that the receiver "continue and manage its properties and business," etc., and "that after the corporate debts are paid or secured to the satisfaction of this (District) Court, the assets of said grocery company be restored to it" (R. 7). By resolution the grocery company consented to the appointment of a receiver (R. 9). The order appointing the receiver, made February 9, 1926, authorized the receiver

"to carry on the business now carried on by Worden Grocer Company" R. 11).

Thereafter, on February 28, 1930, the petitioner herein, in behalf of the People of the State of Michigan, petitioned said District Court (R. 12) for an order compelling the receiver to file annual reports with him as Secretary of State, and to pay to him, as Secretary of State, the corporation privilege tax for the years 1926, 1927, 1928 and 1929, stipulated by counsel to amount to $10,988.26 (R. 22 and 24). Said privilege tax being imposed by Acts 84 and 85 of the Public Acts of 1921 (R. 13).

On August 1, 1930, the District Court, through Judge Raymond, granted the prayer of said petition and ordered the payment of said privilege taxes. (R. 19). It appears from the order of the district Court that the assets of the grocery company were sold on December 30, 1929 (R. 20); that the receiver has paid a 25 per cent dividend to the common creditors (R. 20). No part of said tax has been paid.

ADDITIONAL FACTS FOUND BY UNITED STATES DISTRICT COURT

"In the present case there is no question that during the years for which it is sought to apply the privilege tax the receiver actively conducted the corporation business. * * * The bill of complaint filed in this cause asked for the appointment of receiver with power to take possession of all the property, assets and business of the corporation and with full power to operate, continue and manage the properties and business. This was consented to by resolution of the board of directors of the corporation, the resolution being adopted on the same day on

which the bill of complaint was filed. There is in the bill of complaint *no averment of insolvency or indication of intent either to dissolve the corporation or to wind up its affairs.* There is the clear expression of the purpose or at least the expectation that when the then present emergency had passed there would be left a surplus for the corporation. The evident purpose of the bill of complaint was to have the business of the corporation continue without interruption by creditors or others and the aid of the court was invoked to prevent such interruption by what amounted in effect to the declaring of a moratorium against creditors. For the purpose of staying the hands of creditors, the board of directors surrendered its custody and control of the property of the corporation. For all other purposes it continued. The destiny of the corporation was to a considerable extent still under its control. It might have filed a petition in bankruptcy (see Struthers Furnace Co. v. Grant, 30 Fed. (2d) 576). When, after several years of operation, the hope vanished that the normal corporate activities might be resumed the board of directors might have filed a formal notice of dissolution without affecting the receivership. They probably could have filed a certificate reducing the amount of its capital stock. The indisputable fact is that the corporation retained the privilege of exercising its franchise throughout the claimed taxable period and that the receivers continued to operate the business. In this case, it is undeniable that the board of directors of the corporation and the receiver (whose appointment and activities it either sought or concurred in) continued to exercise all of the privileges of the franchise of the Worden Grocer Company."

ISSUES

1. Is a receiver of a Michigan corporation, alleged to be solvent, appointed by a United States District Court, with the consent of the Board of Directors, to carry on the business of the corporation, rather than to wind up its affairs, liable for the state corporation privilege taxes which accrue during the period of the receivership?

2. Was the Circuit Court of Appeals correct in holding that the assets in the hands of the receiver should not be chargeable with this tax; but "should it appear that a surplus over indebtedness was payable by the receiver to stockholders, for and on account of their stockholdings, such fund would be chargeable with the claim of the state for franchise taxes, for, to this end alone, the corporation existence must be regarded as continued for the stockholder's benefit. That the state may share in the distribution of assets only if and after other creditors and the expenses of the receivership are paid in full".

MICHIGAN STATUTES INVOLVED.

(Numbers in parentheses refer to the compiler's sections in Compiled Laws, 1929. The asterisks denote omission of irrelevant matter; and the italics are ours).

The privilege fees here claimed, were imposed by the State of Michigan pursuant to the provisions of Act 85, P. A. 1921, and during the period in question have provided variously, in part, as follows—

"Sec. 4. (Effective from 1923 to May, 1927) Every corporation organized or doing business under the laws of this state, excepting those hereinafter expressly exempted therefrom, shall, at the time of filing its annual report with the secretary of state of this state, as required by Section 7 hereof, *for the privilege of exercising its franchise and of transacting its business within this state,* pay to the secretary of state, an annual fee of two and one-half mills upon each dollar of its paid-up capital and surplus, but such privilege fee shall in no case be less than ten dollars nor more than fifty thousand dollars." (Act No. 233 P. A. 1923)

The same section as amended by Act 140 P. A. 1927, effective May 11, 1927, reads as follows—

"Sec. 4. (Effective from May, 1927, to May, 1929) Every corporation organized or doing business under the laws of this state, excepting railroad companies and interurban railroad companies, and telephone and telegraph companies, express companies and foreign insurance companies shall, at the time of filing its annual report with the secretary of state of this state, as required by section five of chapter two of part five of act number eighty-four of the public acts of nineteen hundred twenty-one, *for the privilege of exercising its franchise and of transacting its business within this state,* pay to the secretary of state an annual fee of two and one-half mills upon each dollar of its paid-up capital and surplus, but such privilege fee shall in no case be less than ten dollars nor more than fifty thousand dollars."

By Act No. 175, P. A. 1929, effective May 20, 1929, (C. L. Sec. 10140) the legislature added to said Section 4, as previously amended, the following—

"Sec. 4. * * * It is the intent of this section to impose the tax herein provided for upon every corporation, foreign or domestic, *having the privilege of exercising corporate franchises within this state, irrespective of whether any such corporation chooses to actually exercise such privilege during any taxable period.*"

The general corporation act, Act No. 84 P. A. 1921, during the period in question has provided variously, in part, as follows—

Section 5, Chapter 2, Part V thereof, (C. L. Sec. 10127) as amended by Act No. 72 P. A. 1929, in ways not affecting the issues at bar, provides in part as follows—

"Sec. 5. Every corporation organized for pecuniary profit * * * excepting only railroad companies and interurban railroad companies, telephone and telegraph companies, express companies and foreign insurance companies, shall, annually in the month of July or August file a report in duplicate with the secretary of state showing its condition at the close of business upon the thirty-first day of December, or upon the date of the close of its fiscal year, next preceding, on suitable blanks to be furnished by the secretary of state as hereinafter provided: * * * Such report shall furnish the secretary of state with all information and facts necessary for the computation of the annual franchise fee provided by law. The secretary of state is hereby authorized to require of any corporation any additional information that may be needed after the filing of its annual report for the purpose of computing such fee. * * * Such reports shall be * * * deposited in the office of the secretary of state within the said month of July or August accompanied by a filing fee of two dollars, and the amount of the annual franchise fee provided by law." * * *

Section 6 of said chapter (C. L. Sec. 10128) provides, in part, as follows—

> "Sec. 6. * * * If any corporation neglects or refuses to make and file the reports required by this chapter within the time herein specified, and shall continue in default for ten days thereafter, its corporate powers shall be suspended thereafter, until it shall file such report, and it shall not maintain any action in any court of this state upon any contract entered into during the time of such default."
> * * *

Section 7 of said chapter, added by Act 172 P. A. 1923, provided, until the 1929 amendment, in part as follows—

> "Sec. 7. * * * If any corporation which is now or may hereafter be required to file its annual report with and pay a franchise fee or tax to the secretary of state, shall for two consecutive years neglect or refuse to file such report or to pay such fee or tax, the charter of such corporation shall be void unless the secretary of state shall for good cause shown extend the time for the filing of such report or the payment of such fee or tax as the case may be. In case of an extension of time as provided in this section, the secretary of state shall file in his office a certificate showing the length of time granted by such extension: Provided, That in no case shall the total extension of time granted be more than one year."

Following a holding by the Supreme Court of Michigan that this provision regarding the forfeiture of franchise was not self-executing (Turner v. Western Hydro-electric Co. 241 Mich. 6) the following amendment being C. L. Sec. 10130 was enacted, and became effective August 28, 1929, making the forfeiture provision self-executing—

"Sec. 7. * * * If any corporation which is now or may hereafter be required to file its annual report with and pay a privilege tax to the secretary of state shall for two consecutive years neglect or refuse to file such report or to pay such fee or tax, the charter of such corporation shall be absolutely void, without any judicial proceeding whatsoever, unless the secretary of state shall for good cause shown extend the time for the filing of such report or the payment of such fee or tax as the case may be. In case of extension of time as provided in this section the secretary of state shall file in his office a certificate showing the length of time granted by such extension: Provided, that in no case shall the total extension of time granted be more than one year. *The provisions of this section are hereby declared to be self-executing.*"

Section 7, Chapter 4, Part I, (C. L. Sec. 9976) provides in part as follows—

"Sec. 7. In any case where a corporation shall be dissolved by process of law, or whose term of existence shall terminate by limitation and not be renewed, or whose property and franchise shall be sold at mortgage sale, or if for any reason the attitude of the corporation toward the state shall be changed from that set forth in the articles without a formal dissolution, it shall be the duty of the last board of directors thereof, within thirty days thereafter to file a certificate to such effect with the secretary of state signed by a majority of the remaining members of such board and accompanied with the fee prescribed, which certificate shall be filed or recorded along with the original articles." * * *

CONSIDERATION OF MICHIGAN STATUTES AND CONSTRUCTION PLACED THEREON BY MICHIGAN SUPREME COURT

It clearly appears from the Michigan statutes above quoted that the tax imposed upon corporations is levied upon the corporate franchise "to do" rather than the corporate franchise "to be". This construction was placed upon the statute by the Supreme Court of Michigan in Union Steam Pump Sales Company v. State, 216 Mich. 271, decided in 1921, where the court quoted with approval from Joyce on Franchises, Sec. 38, as follows:—

> "The franchise of being a corporation belongs to the corporators, *while the powers, rights and privileges* vested in and to be exercised by the corporate body as such constitute *franchises* of the corporation."

The Supreme Court of Michigan In Re G. H. Hammond Co., 246 Mich. 182, decided in March, 1929, said:—

> "Michigan has seen fit to adopt legislation by which the annual privilege fee is imposed upon a corporation *organized* under its laws *regardless* of whether the corporation does any business within the state."

In the Hammond case it appeared that the corporation which was ordered to pay the tax was a Michigan corporation, with an office in Michigan, but that it transacted no corporate business in Michigan. The Supreme Court called particular attention to the language of the statute which imposed the tax on any corporation *organized* under the laws of Michigan and sustained the payment of the tax.

Our Supreme Court of Michigan in Re Detroit Properties Corporation, 254 Mich. 524, decided in June, 1931, called attention to the foregoing decisions and approved the construction placed upon the corporation laws of this state, holding a receiver who had been appointed to carry on the business of a solvent corporation liable for the corporation privilege tax maturing after the receiver was appointed.

Circuit Court of Appeals Follows In Part The Decision of the Supreme Court of Michigan

The Circuit Court of Appeals in the instant case recognizes the liability of the corporation in question to pay the privilege tax maturing during the period of the receivership, but holds that the tax is only payable out of funds in the hands of the receiver, after the expenses of the receivership and all creditors have been paid, basing said conclusion upon the reasoning that the receiver did not use any of the franchises of the corporation, and that the receiver takes the property charged only with the debts and liabilities of the corporation, which exist at the time of his appointment. The Circuit Court of Appeals justifies this conclusion by holding that the receiver of a private corporation may transact any act which might be performed by any other citizen in total disregard of the corporate capacity of the former possessor of the property, and without any reliance whatever upon its franchises. That the limitation to the effect that the receiver may normally transact only such business as is authorized by the corporate charter arises from the implied contract between the corporation and its stockholders that the money invested shall be used only for such purposes.

ARGUMENT

Prior to an analysis of the rules of law applicable to the question now before this court, we wish to stress the following undisputed facts in the case at bar:

1. The corporation was not insolvent at the time the receiver was appointed by and with the consent of the directors.

2. The receiver carried on the business of the corporation for a period of upwards of 3½ years, and took possession of and proceeded to collect all the accounts and obligations of said corporation.

3. That the trial court, the U. S. District court in sustaining the payment of this tax, after listening to the argument of counsel in open court and being fully advised in the premises found as a fact, that the Board of Directors of the corporation and the receiver continued to exercise all the *privileges* and *franchises* of the Worden Grocer Company.

4. That the order appointing the receiver provided for the payment by it of "*all taxes and assessments* levied upon the property and assets of said company".

5. That the company, its officers, servants and agents were only enjoined by an order of the court made at the time the receiver was appointed, from receiving debts and transferring effects of any kind and interfering with the operation and conduct of the business.

6. That the corporation was not terminated until after December, 1929, when the property was sold by order of the court, which was after the 1929 tax was payable.

7. That the receiver by reason of the order of the court took into his possession all property and assets of the corporation and after conducting said business for a period of upwards of 3½ years has distributed to the

common creditors of the said corporation a dividend of twenty-five per cent.

8. That under the decision of the Circuit Court of Appeals the corporation tax in question is payable out of any surplus over indebtedness payable by the receiver to the stockholders for and on account of their stock holdings, and that the state may share in the distribution of assets only if and after other creditors and expenses of the receivership are paid in full. Under this decision, common creditors of the corporation are preferred to the claim of the state for this tax.

The Argument Will Be First Presented By Grouping as Assignments of Error the Several Conclusions Reached by The Circuit Court of Appeals, in the Order in Which They Appear in the Opinion of That Court, as follows:

1. That the court erred in holding that the receiver in the instant case did not exercise any of the franchises of the corporation, and that the receiver, may perform under the direction of the court, any act which might be performed by any other citizen, in total disregard of the corporate capacity, and without any reliance upon its franchises.

2. That the court erred in holding that the limitation upon the power of the receiver to transact only corporate business, arises solely by reason of the implied contract between the stockholders and the corporation.

3. That the court erred in making a distinction between a public utility corporation, and a private corporation, indicating that in the case of a public utility corporation, a receiver would be liable for the corporation privilége tax.

4. That the court was in error in citing United States v. Whitridge, 231 U. S. 144, in support of its

contention that the receiver was not liable for the privilege tax.

1.

The Circuit Court of Appeals Erred in Holding That The Receiver In the Instant Case Did Not Exercise Any Of The Franchises Of The Corporation, And That The Receiver, May Perform Under The Direction Of The Court, Any Act Which Might be Performed By Any Other Citizen, In Total Disregard Of The Corporate Capacity, And Without Any Reliance Upon Its Franchises.

Let us first consider what is meant by "Franchises of The Corporation", as used in the statute imposing said tax. When the Michigan legislature used the term "for the privilege of exercising its franchise", did "franchise" mean a special right or privilege granted a public utility corporation to engage in a public enterprise, or did it mean all rights, privileges and powers granted a corporation, whether public or private? We believe it is clear that the legislature used the term in the latter sense, because the act in question expressly excepts from its operation such public utility corporations as "railroad companies, interurban railroad companies, telephone and telegraph companies, express companies, and foreign insurance companies."

The Michigan Supreme Court in Union Steam Pump Sales v. State, supra, defines "franchises", as follows:

> "The franchise of being a corporation belongs to the corporators, while the *powers, rights* and *privileges* vested in and to be exercised by the corporate body as such, *constitute franchises* of the corporation."

This interpretation of the Michigan Supreme Court, of a local statute, should be accepted and followed in Fed-

eral Courts. In 3 Thompson on Corporations (2d Ed.), Sec. 2864, the author says:

> "On the other hand, the secondary or *annexed franchises*, by which is meant the *privileges, powers and franchises* of the corporation necessary to its operation and the properties possessed by it, belong to the corporation as a corporation and not to the individual members or corporators."
>
> "The word 'franchise' is to be regarded as a generic term covering all rights granted to a corporation by legislative act or statute. Cedar Rapids Water Co. v. City of Cedar Rapids, 91 N. W. 1081.
>
> "The right to be and do business as a corporation is a franchise. The power to exercise a franchise is one of the most important a corporation can acquire." Iron Silver Min. Co. vs. Cowie, 72 Pac. 1067.

In Mather's Son's Co.'s Case (1894) 52 N. J. Equity Reports 608, the issue was the payment of a franchise tax by a receiver of a private corporation. It appeared that the receiver carried on the business of the corporation under order of the court. The court said "a receiver does not necessarily in every case deal with the corporate entity or its franchise. His duty may be confined entirely to the administration of assets which exist at the time of his appointment."

The court held the tax payable saying:

> "What is to be considered an exercise of franchise of an insolvent corporation by a receiver may vary with the circumstances in each case. Where the ordinary and usual business of the corporation is continued, as in the present instance, at a profit, in the name of the company, by the receiver, in the hope that financial difficulties may be adjusted and

the assets may be restored to the company, there can be little discussion in concluding that it is the duty of the receiver to pay the tax while he continues the business."

In Providence Engineering Corp. (1925) 8 F. (2) 304, the court in holding a private corporation liable for a privilege tax maturing during the receivership, said:

"The receivers had the right and did actually to some extent carry on the business of the corporation which thereby became liable to pay the tax. The corporation which was alleged to be solvent, had all the benefit to be derived from the right to conduct business."

It therefore follows that the right to engage in business under the name of Worden Grocer Company; to carry on the grocery business as such; to hold and convey property; to collect accounts and to do all things necessary to carry on the business of said corporation, are franchises granted said corporation. When the receiver under the order of the court took over the management of the business of said corporation, and undertook to collect all assets of said corporation, and finally when he consummated a sale of all the property of said corporation, he was through the order of the court, exercising franchises which had been granted said corporation.

As to the effect of the Appointment of a Receiver on the Franchises of a Corporation, we submit the following:

(Sec. 703 of Clark on Receivers) "The appointment of an equitable receiver and manager of a company over the assets and business of the company does not dissolve or annihilate the company. Both

continue to exist; but it entirely supersedes the company in the conduct of its business, deprives it of all power to enter into contracts in relation to that business, or to sell, pledge, or otherwise dispose of the property put into the possession, or under the control of the receiver and manager. Its powers in these respects are entirely in abeyance. A court of equity can not kill or destroy an individual, neither can it destroy a corporation, but it can take possession of the business and property of an individual, to preserve or realize for creditors and it can take possession of the business and property of a corporation and preserve it or realize it for creditors, and in doing so, leave nothing but the shell of the corporation. It can not destroy that shell, however, except by statute."

(Section 707 of Clark on Receivers) "As regards a general equity or pendente lite receiver appointed by the federal courts or appointed by a state court not under a statute, the legal existence of a corporation is not cut short by the appointment of such a receiver. The existence of the corporation is not suspended. It is still the corporate entity that it was before. It is clothed with the same franchises and its corporate powers continue to exist subject in their exercise of course to limitations arising out of the changed conditions and situations. Under such circumstances the corporation may generally do all things necessary to preserve its legal existence notwithstanding the appointment of the receiver to which the temporary management of the corporation's property is given,—otherwise the appointment of the receiver would be tantamount to a dissolution of the corporation."

"It has further been held in New Jersey that putting a corporation in charge of a receiver does not work its dissolution, but that meanwhile the corporation exists with all its franchises exercisable by the receiver in the management of its affairs, subject to all the duties, obligations and liabilities that rested upon the corporation itself."

"Although a receiver may operate a railroad or other public utility, ordinarily enjoying the full franchises which the railway formerly owned, nevertheless such a receiver cannot exceed those franchises any more than the original owner of the franchise could so exceed the franchise. Furthermore, a court operating such a property must operate the same through its receiver within the limits and rights laid down by the franchises authorizing such railroad or other public utility to so operate." Citing Gas & Electric Securities Co. v. Manhattan & Queens Traction Corporation (1918), 253 Fed. 453.

(Section 861 of Clark on Receivers) "Though appointed by a Court and acting as its officers, the receivers of a railroad corporation, who are authorized to operate and manage a railroad, stand, for the time being, in many important respects, in the place of the corporation itself. They have sole possession of the railroad and of the property belonging to the corporation. They run trains, carry passengers, transfer freight, and conduct in the usual manner those active operations for which the railroad was intended and constructed. They act as common carriers by virtue of and under the franchise conferred on the corporations, and as such, so far as the public is concerned, are subject to the same duties and liabilities, in very many, if not all respects, to which the corporation is subject, and which are imposed on it by the exercise of the power conferred by the franchise." Citing Erb v. Morasch (1900) 177 U. S. 584.

In Central Trust Co. v. New York, (1888) 110 N. Y. 250, 18 N. E. 92, the court of last resort of the State of New York held that where a receiver of a railroad company was operating the road, recourse might be had to the funds in his hands for the payment of the tax on the franchise of the corporation levied under the New York corporation tax act, the court saying in part:

"It is claimed, however, that when a receiver is appointed by the court, if he operates the railroad under its order, he does so by virtue of the equity powers of the court conferred by the constitution; and hence that the receiver is not bound to pay the taxes, although he receives all the earnings of the company. But what does the receiver operate? Under this order of the court he takes possession of all the property of the corporation, and proceeds to operate, that is, to run, its trains, and to do all that was formerly done under the direction of the board of directors. IN THIS WAY HE USES THE FRANCHISE WHICH HAS BEEN CONFERRED BY THE STATE UPON THE COMPANY AND HE USES IT AS AN OFFICER OF THE COURT WHICH IS ADMINISTERING THE AFFAIRS OF THE COMPANY AND THROUGH THE COURT HE ACTS AS THE COMPANY TO THE SAME EXTENT PRO HAC VICE, AS IF THE BOARD OF DIRECTORS WERE OPERATING THE RAILROAD. IT IS THE FRANCHISE WHICH IS BEING USED IN BOTH CASES, only in one case it is used for the company, and substantially by it, by means of its board of directors; while in the other case the same franchise is being used, and the road is operated under it, by an officer of the court, until, by virtue of the legal proceedings, connected with the receivership, the receiver is discharged and the road returned to its former possessors, or other proceedings taken under a reorganization, as provided by law."

The above decision was reached as early as 1888. Again in 1912 the same court, in New York Terminal Company v. Gaus, 204 N. Y. 512, 98 N. E. 11, reaffirmed the right of the state to collect such fees against a receiver "for the privilege of doing business or exercising its corporate franchise." The court said:

"It is the contention of the appellant, in effect, that the provisions for a franchise tax have no application to such a case as this, where the corporation is in the hands of a receiver and has ceased itself, to operate. I think the fallacy of the contention is in an evident assumption that, in his conduct of the business of the corporation, the corporate franchise is not being used by the receiver. The tax levied by the comptroller by virtue of section 182 was a tax upon the franchise, as distinguished from the property of the corporation. It is imposed, as it declares, upon the privilege of carrying on business and of exercising the corporate franchises."

A comparison of the statutes of New York, imposing these privilege fees, with those of Michigan indicate that the two are almost identical since both are directed at the privilege of doing business and not at the doing of the business itself.

In In Re U. S. Car Co., 60 N. J. Equity, 514, 43 Alt. 673, it appears from the statement of facts in the opinion that "The receivers in the present case have not in their hands assets sufficient to pay those debts of the corporation which existed at the time of their appointment; nor have they continued the business of the corporation in any way, nor exercised any of its franchises." The question presented to the court was whether under these circumstances the state was entitled to priority in payment out of the assets in the hands of the receiver of a tax assessed against the corporation after their appointment. In the court below it was held that since the corporate franchises were useless and since also they had not been used by the receivers, the tax was not collectible until after all indebtedness existing at the time of the appointment of the receivers was discharged. This holding was reversed by the appellate court, with the following language:

"We cannot concur in this view. Although the statute designates an imposition of this kind as a license fee or franchise tax, it plainly is not a tax upon corporate franchises. In fact, it is not, strictly speaking, a tax at all, nor has it the elements of one. It is in reality an arbitrary imposition laid upon the corporation, without regard to the value of its property or of its franchises, and without regard to whether it exercises the latter or not, solely as a condition of its continued existence."

"The State, in creating a corporation, has the right to impose upon its creation such conditions as the legislature, within constitutional limits, may deem proper; and the acceptance by the corporation of the franchises, powers, and privileges conferred upon it binds it to the performance of those conditions, so long as it continues to remain in possession of those franchises, powers, and privileges, and the conditions themselves remain unrevoked by the legislature. And this is so without regard to the solvency or insolvency of the corporation, the value or want of value of its franchises, or whether or not it is exercising them, either by its officers and directors, or through a receiver. The sole test, in determining its liability to comply with those conditions, so long as they remain unrevoked, is the existence or nonexistence of the corporations. Applying this test, it is quite clear that the so called tax was properly imposed in the present ease. At the time of its imposition, although the company had been decreed to be insolvent, no decree of dissolution had been pronounced against it; but, on the contrary, its corporate life was continued for the benefit of its creditors pending the final distribution of its assets."

In Armstrong v. Emmerson, 300 Ill. 54, 18 A. L. R. 700, it appeared that the plaintiff was receiver of a railway corporation under a United States District Court Degree and had operated the railroad pursuant to authority granted by the court. The secretary of State as-

sessed the annual license fee or franchise tax upon the capital stock of the company and demanded payment of the receiver. Payment was made under protest and a bill filed to require its repayment to the receiver. The bill was however dismissed, the court saying in part:

> "We have held that the appointment of a receiver for a railroad company creates no change in the corporate body, but its existence remains, with its legal functions unimpaired, its acts being performed by agents appointed by the court, and not by the corporation. The court does not enlarge or restrict the powers and duties conferred by the charter, but assumes the management of the corporation, under and in accordance with the charter, and is bound by its provisions, and the agents appointed by the court are inquired to act within the limits of the charter and to perform the duties imposed by it.
>
> "In Central Trust Co. v. New York Central and Hudson River Railroad Co., 110 N. Y. 250, it was held the receiver was liable to the franchise tax. It was said: 'It is claimed, however, that when a receiver is appointed by the court, if he operates the railroad under its order he does so by virtue of the equity powers of the court conferred by the constitution, and hence that the receiver is not bound to pay the taxes although he receives all the earnings of the company. But what does the receiver operate? Under this order of the court he takes possession of all the property of the corporation and proceeds to operate,—that is, to run,—its trains and to do all that was formerly done under the direction of the board of directors. In this way be uses the franchise which has been conferred by the State upon the company, and he uses it as an officer of the court which is administering the affairs of the company, and through the court, he acts as the company to the same extent pro hac vice as if the board of directors were operating the railroad. It is the franchise which is being used in both cases, only in one case

it is used for the company and substantially by it by means of its board of directors, while in the other case the same franchise is being used and the road is operated under it by an officer of the court, until, by virtue of the legal proceedings connected with the receivership, the receiver is discharged and the road returned to its former possessors or other proceedings taken under a re-organization, as provided by law.' "

Thompson on Corporations, says on this point:—

"Insolvency of a corporation does not relieve its franchise from liability to assessment in states having franchise tax laws. The franchises are still exercisable by the receiver. It follows that the receiver of a PRIVATE INSOLVENT CORPORATION continuing its business and using its franchise is liable for the franchise tax assessed while continuing the business." Vol. 3, Sec. 2941 (2nd. Ed.)

Many other cases might be cited in support of the obligation of a receiver to pay franchise privilege fees, based on the reasoning that *the court* has become the custodian of the *Corporate franchises,* and the receiver as an officer of the court in carrying on the business of the corporation, exercises said franchises. Most of these cases were summarized in an opinion of the Circuit Court of Appeals of the 8th Circuit, in Bright et al. v. State of Arkansas, (1918) 249 Fed. 950, where the court scrutinized the most important cases which had previously passed upon this question, and concluded:

"* * * * * by the great weight of modern authority, that courts of equity, operating the property and liquidating the debts of corporations, which would otherwise have been liable to pay such taxes, ought to direct the payment by their receivers of such

taxes as would have accrued during the time the receivers were actually operating the property."

It appears that in that case the State of Arkansas imposed an annual tax on the railroad company "for the privilege of exercising its franchise in the State of Arkansas." An order of the District Court requiring the receivers to pay these franchise taxes for two years of the receivership was appealed from. In affirming this order the court of appeals said:

> "In view of the uniform decisions of the federal courts upon the question here at issue, and of the great weight of authority in favor of the practice they have adopted, the conclusion is that receivers of the property of corporations, which would have been liable to pay taxes accruing during the receivership for the privilege of exercising their corporate powers, should be directed by the courts of equity controlling such receivers to pay such taxes as accrue while they are operating the property and before they surrender it to purchasers or others, and that there was no error in the order of the court below requiring the receivers to do so in the case at hand."

Additional decisions in support of this view are found in subsequent cases. Thus, in Providence Engineering Corporation v. Downey Shipbuilding Corp. 8 Fed. (2d) 304, exceptions were taken to the report of a special master in the matter of the claim of the State of New York for franchise taxes. The District Judge however sustained the exceptions and the portion of his opinion pertinent to this issue is as follows:

> "The learned master also found that the franchise tax for the period ending October 31, 1922, in the sum of $5,783.47 should be disallowed by reason of

the fact that no evidence was produced indicating that the receivers had carried on the corporation's business during this period. It is my opinion that this assessment is not subject to review in this court, for the reason hereinbefore set forth, and for the additional reason that the receivers had the right and did actually to some extent carry on the business of the corporation which thereby became liable to pay the tax. The corporation which was alleged to be solvent, had all the benefit to be derived from the right to conduct business."

To the same effect see Liberty Trust v. Gilliland, 279 Fed. 432.

In People v. Hopkins, (1927) 18 Fed. (2d) 731, the court passed upon a claim of the State of New York for privilege fees, asserted under Sections 209 and 214 of Article IX-A of the Tax Law, (Consolidated Laws c60), which, as we have previously pointed out, is identical with the Michigan law in that the imposition is there also on the privilege of doing business. The claim in that case centered around franchise taxes covering years long subsequent to the appointment of the receiver and the receiver pressed this fact upon the court in resisting the State's claim. The court ordered the taxes paid, however, saying:

"With respect to property taxes, it is perfectly obvious that the custody of the receiver should not give the property immunity from taxation. The Supreme Court has stated, with reference to bankruptcy, that there is nothing in the dedication of property to the payment of creditors which withdraws it from the necessity of protection by the state and municipality, or exempts it from its obligations to either. Swarts v. Hammer, 194 U. S. 441, 24 S. Ct. 695, 48 L. Ed. 1060. This reasoning is equally

apposite to a chancery receivership, and there is no lack of authority on the point. Coy v. Title Guarantee & Trust Co., 220 F. 90, L. R. A. 1915E, 211 (C.C.A. 9). With respect to franchise taxes, the result should be the same, and is, when the statute is construed as a tax upon the privilege of continued existence as a corporation. New Jersey v. Anderson, 203 U. S. 483, 27 S. Ct. 137, 51 L. Ed. 284. When the statute is construed as a tax upon the privilege of exercising the corporate franchise—that is, of continued operation of the corporate business—franchise taxes subsequent to the receivership are usually upheld if in fact the receiver has continued the business. Bright v. Arkansas, 249 F. 950 (C. C. A. 8); McFarland v. Hurley, 286 F. 365 (C. C. A. 5); Ohio v. Harris, 229 F. 892 (C. C. A. 6). Compare United States v. Whitridge, 231 U. S. 144, 34 S. Cot. 24, 58 L. Ed. 159."

"In New York v. Jersawit, supra, Mr. Justice Holmes, expressed the opinion that the tax levied under section 209 is a tax upon the privilege conferred, not upon the actual exercise of it. No decisions by the courts of the state of New York have been called to our attention, nor have we found any, which throw doubt upon the accuracy of this interpretation of the statute. See Cayuga & A. R. R. Co. v. Del. L. & W. R. R. Co., 215 App. Div. 429, 213 N. Y. S. 586 (construing section 182 similarly). Consequently we are of opinion that the taxes assessed against the corporation during the years in question were valid taxes, which must be paid by the receivers in priority to general debts."

A recent case on the subject is that of In re. Malko Milling and Lighting Company, 32 Fed. (2d) 825, which came to the District Court on exceptions to the allowance of the referee on the claims of certain creditors. The Malko Company went into the hands of receivers in the State Court in November, 1924. In the latter part of

January, 1925, a petition in bankruptcy was filed against the company and an adjudication followed in the same month. The trustee in bankruptcy was appointed in March. The State of Maryland asserted a claim for franchise taxes, payable on the first day of September on the capital stock outstanding on the first day of the preceding January. The trustees resisted the payment of the franchise tax on the ground that the tax was not levied on property but was in the nature of a license fee for the right to continue to exercise the privilege conferred upon it by the State and that since the receivership in November, 1924, there was in realty no corporate existence. The following is the opinion of the court:

> "The court finds that the trustee's contention is unsound. Although it is true that the tax did not accrue until after the state receivership, this receivership did not in law terminate the corporate existence. * * * * The tax is laid on the right 'to be a corporation'; that is, a tax upon the right conferred, not upon the actual exercise of it, regardless of what may be the reason for the nonexercise."

The Supreme Court of Massachusetts in Collector of Taxes v. Bay State St. Railway Co. (1919), 234 Mass. Reports, p. 340, in discussing the result of the appointment of a receiver upon the corporate franchises, said:

> "The title to the property of the street railway company was not transferred to the receiver. He became its custodian, not its owner. He was the officer of the court making the appointment and his possession was the possession of the court. The purpose of his appointment was to conserve the property of the company. The nature of the property and assets of the company could be best preserved by its continued operation. His operation of it as a common carrier was in the exercise of the

rights and franchises of the street railway company. *Although he was not the agent of the company, he used all its privileges.* Property taxes still rightly would be assessed to the company. City National Bank v. Charles Baker Co., 180 Mass. 40. Harrison v. J. J. Warren Co., 183 Mass. 123. The corporation is not dissolved in form or in substance. Being a common carrier, its property is affected with a public interest. One object of the receivership of such a corporation is to enable it to continue the exercise of its corporate franchises and functions and to avert a suspension of their operation with the consequent inconvenience to the traveling public and loss of revenue and loss of good will, and the prevention of change of custom by the public as to their patronage of it. Property in the hands of a receiver is not withdrawn from taxation. Property taxes rightly are assessed against the company. It is the plain duty of the court to see that such taxes are paid. City National Bank v. Charles Baker Co., 180 Mass. 40. Harrison v. J. J. Warren Co., 183 Mass. 123. In re Tyler, 149 U. S. 164, 183, Kirkpatrick v. Board of Assessors, 28 Vroom, 53. Coy v. Title Guarantee & Trust Co., 135 C. C. A. 658. Since the *franchises* of the corporation *are exercised for the benefit of its creditors,* there is no reason or principle why excises based on such use of its franchise should not also be paid by the receiver. The authorities are to this effect. Central Trust Co. v. New York City & Northern Railroad, 110 N. Y. 250. State v. Sessions, 95 Kans. 272, 279. New York Terminal Co. v. Gaus, 204 N. Y. 512. Bright v. Arkansas, 162 C. C. A. 148; 249 Fed. Rep. 950. In re United States Car Co., 15 Dick. 514.

"There is nothing in the phraseology of said §§ 47, 48, 50 of Part III of the tax law which render them inapplicable to the facts here disclosed. The tax is assessed on the street railway company by express terms. The return containing the information on which the tax is to be levied must be made under oath by its president and treasurer. There is

no insuperable difficulty in this being done. These corporate officers must still be in existence. It is the duty of the receiver to furnish them the data on which to make the return. The words of those sections are used in a 'comprehensive sense sufficiently broad to include parties holding the relation to a corporation which receivers of a railroad corporation usually do.'" Wall v. Platt, 169 Mass. 398, 401. The decision in that case supports inferentially the conclusion here reached. It there was held that receivers of a railroad were liable to action under a statute holding 'every railroad corporation' responsible in damages for injuries resulting from 'fire communicated by its locomotive engines.'

"There is nothing in the pertinent sections of the statute which affords solid foundation for the contention that the appointment of a receiver makes any break in the period for which the tax is assessed. There has been no change in ownership. The purpose of the operation has been all the while the benefit of the street railway company and its creditors and the public. The same franchise of operation has been continuously exercised for the same ultimate property and public interests. The principles discussed and applied in Natick & Cochituate Street Railway v. Wellesley, 207 Mass. 514, are not apposite to the facts here disclosed.

"There are numerous cases which have held that a corporation in the hands of a receiver is not subject to a franchise tax. Those are cases, however, where the corporation has been prohibited by law or by injunction from exercising its franchises and the receiver is not using them, or the corporation is in process of liquidation. Commonwealth v. Lancaster Savings Bank, 123 Mass. 493. Greenfield Savings Bank v. Commonwealth, 211 Mass. 207. It was in this connection that it was said by Chief Justice Holmes in City National Bank v. Charles Baker Co., 180 Mass. 40, 43, that when a corporation was insolvent and in the hands of a receiver 'the franchise is not taxed.' Under such circumstances the mere

franchise to be a business corporation has under our tax laws no value which is made subject to taxation. Johnson v. Johnson Brothers. 108 Maine, 272. State v. Bradford Savings Bank, 71 Vt. 234. These cases have no pertinency to the facts here disclosed. *The decision in United States v. Whitridge, 231 U. S. 144, construed a different kind of a statute and is not of controlling significance on the facts here disclosed.*"

Whether or not a receiver in carrying on the business of a private corporation, exercises any of the franchises of a corporation was squarely raised, carefully considered and answered by the Supreme Court of Michigan, in June 1931, In re Detroit Properties Corporation, 254 Michigan 530, wherein the court said:

"On receivership, the corporation is not divested of its franchises, nor do they lapse. The court merely takes them into its custody for a time. The franchise 'to do' passes to the control of the court. Detroit, etc., R. Co. v. Campbell, 140 Mich. 384; Grand Rapids Trust Co. v. Carpenter, 229 Mich. 491; United States v. Whitridge, supra.

"The receiver is the creature or officer of the court and is not an agent of the corporation. Face v. Hall, 183 Mich. 22. But when he is authorized to carry on the business of the corporation, his authority does not come wholly or solely from the equity powers or jurisdiction of the court. The grant of corporate powers is a legislative function. The court, out of its own powers, cannot confer them upon an individual. It could not authorize the receiver to conduct a business not within the corporate charter. The power of the court to authorize the receiver to continue the business of the corporation exists only because the court has become the custodian of the corporate franchises. In so authorizing, it merely directs the person who shall exercise powers belonging to the corporation by legislative grant.

"The receiver of a corporation, conducting its business takes the place of the corporation and its officers for the purpose of performing the necessary corporate duties and functions, and has the same powers for such purposes, while on the other hand, he cannot act in excess of the corporate powers and the court cannot invest him with authority to that extent." 14-A. C. J. p. 1005.

"So it follows that, in conducting the business under order of court, the receiver is exercising the franchise 'to do' of the corporation. Substantially all the above authorities sustaining the tax so hold. See, also, State v. Sessions, 95 Kan. 272, 278 (147 Pac. 789).

"The tax is on the franchise, and, as the franchise is being exercised by the receiver, the tax is valid."

This ruling of the Supreme Court of Michigan, construing the state statute imposing the tax here under consideration, wherein the court fully and carefully considered every question raised in the Circuit Court of Appeals, we submit should be followed by Federal Courts. To hold otherwise would enable a corporation in the hands of a Federal receiver to escape the payment of said tax; while a corporation in the hands of a state receiver would be required to pay the same.

The court is familiar with the rule it has adopted and followed consistently, as aptly stated in 27 R. C. L. page 44:

"In the construction of local statutes the decision of a state court of last resort will govern the Federal Courts; although the same act may have received a different construction in other states."

This rule has been followed in giving effect to decisions of state courts involving taxation.

We appreciate that the Circuit Court of Appeals in the instant case has assigned as a reason why it did not

follow the decision of the court of last resort of this state, on the question here under consideration, that "No question of the construction of a state statute by the highest court of the state was there or is here involved." (R. 34). We cannot accede to this conclusion. The tax in question is purely statutory. Whether or not the tax is payable by a receiver depends upon the nature of the tax, which can only be determined by a construction of the particular statute. This court in United States vs. Whitridge, supra, in determining whether or not a receiver of a corporation should pay a corporate income tax, was required to construe the statute. Again the Circuit Court of Appeals in People vs. Hopkins, supra, in determining the liability of a receiver for a corporate privilege tax, construed the statute imposing said tax.

The Circuit Court of Appeals in the fore part of its opinion adopts in part the construction placed upon that statute by the Michigan Supreme Court. It did not give weight or consideration to the decision of the Michigan Supreme Court in Re G. H. Hammond Co., supra, where our court held the tax in question was payable, "regardless of whether the corporation does any business within the state."

Under Sec. 124 of the Judicial Code, the Federal receiver in the instant case was required "to manage and operate" the property of this corporation "according to the requirements of the valid laws of the state in which such property shall be situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

The full text of said section is as follows:

> "Whenever in any cause pending in any court of the United States there shall be a receiver or manager in possession of any property, such receiver or manager shall manage and operate such property

according to the requirements of the valid laws of the state in which such property shall be situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof. Any receiver or manager who shall willfully violate any provision of this section shall be fined not more than $3,000, or imprisoned not more than one year, or both."

We submit that under this statute, and under the order of the district court which provided for the payment of all taxes, that the receiver should pay the taxes herein claimed. It is conceded that the corporation was not dissolved until after it had sold its property in 1929, and therefore under the state decisions the tax is payable. All the assets of the corporation were taken over by the receiver, who has benefited by them, and a court of equity should therefore follow such assets and impress thereon the lien of the state.

These decisions impress us as supporting the rule that a receiver of a solvent corporation, by operating the corporate business, exercises some of the corporate franchises; that the court takes the franchises of the corporation into its custody for a time; that the franchise "to do" passes to the control of the court; that a court of chancery cannot authorize the receiver to conduct a business not within its corporate charter.

2.

THAT THE COURT WAS IN ERROR IN HOLDING THAT THE LIMITATION UPON THE POWER OF A RECEIVER TO TRANSACT ONLY CORPORATE BUSINESS ARISES SOLELY BY REASON OF THE IMPLIED CONTRACT BETWEEN THE STOCKHOLDERS AND THE CORPORATION, AND NOT FROM ANY DEPENDENCE BY THE COURT UPON THE GRANT OF THE POWERS ENUMERATED IN THE CHARTER.

The following is the rule regarding the origin of the powers of a receiver to carry on the business of a corporation:

> "The receiver of a corporation, conducting its business, takes the place of the corporation and its officers for the purpose of performing the necessary corporate duties and functions, and has the same powers for such purposes, while on the other hand, he cannot act in excess of the corporate powers and the court cannot invest him with authority to that extent." 14-a C. J., p. 1005.

The author of Corpus Juris cites the following case in support of this doctrine:

In Safford v. The People of the State of Illinois (1877) 85 Illinois Reports, page 559, the court was called upon to consider the violation of an injunction issued against a corporation which later passed into the hands of a federal receiver. In discussing the effect of the appointment with reference to the corporate powers, the court said:

> "When the receivers were appointed by the Federal court, there was no change in the corporate body. Its existence was intact, with its legal functions unimpaired, but simply its acts were performed by agents appointed by the court, and not by the corporation. The agents appointed by the court to perform its duties and exercise its functions, are legally its agents, although they are under the direction of the court appointing them, within the limits of its charter. *The court only authorizes the receiver to exercise the privileges and perform the duties prescribed by the charter. The court does not, nor could it if attempted, enlarge or restrict the powers and duties conferred by the charter. When it appoints the receiver, the court assumes the management of the corporation under and in accordance*

with the charter, and is bound by its provisions to the same extent that are the directory, and the agents appointed by the court are required by it to act within the limits of the charter, and to perform all duties imposed thereby.''

In Louisville, New Albany, and Chicago Railroad Co. v. Cauble (1874) reported in 46 Indiana Reports, page 281, the court was called upon to pass upon service of process made after a receiver had been appointed. It said:

"The whole decree proceeds upon the theory that the appellant is a corporation created and existing under the laws of this State. The whole effect of the decree is, to take the custody, control, and management of such corporation out of the hands of the persons who were controlling and managing the same and to place the same into the custody and under the control and management of the receiver for a specified time and for a special purpose. The corporate existence of the appellant was left intact. *The corporate powers and franchises which had been exercised by the officers of the company were conferred for the time being upon the receiver. The power and authority of the receiver to manage and control the company and its operations depended upon its corporate existence. If that had been taken away, the power and authority of the receiver would have ceased and terminated, for no court, federal or state, can confer corporate powers and franchises upon an individual. Such powers can be created and conferred by the legislative department alone.''*

The Supreme Court of New York in New York Terminal Co. v. Gaus (1912), 204 New York Reports, p. 516, in discusing the powers of a receiver appointed to carry on the affairs of a corporation, said:

"Upon the question of what the receiver was operating, Judge Peckham observed that, in taking possession of the corporate property, and in operating it, he 'uses the franchise, which has been conferred by the State upon the company, and he uses it as an officer of the court, which is administering the affairs of the company, and through the court he acts as the company to the same extent pro hac vice as if the board of directors were operating the railroad. It is the franchise which is being used in both cases, * * * the same franchise is being used and the road is operated under it by an officer of the court until, by virtue of the legal proceedings connected with the receivership, the receiver is discharged,' etc. (p. 257). The authority of this decision was, quite lately, recognized and followed in People ex rel Joline v. Williams, (200 N. Y. 528)."

This is the rule adopted by the Supreme Court of Michigan In Re Detroit Properties Corporation, supra, and we submit is sound in principle. While it is true that the implied contract between the stockholders and the corporation prevents the receiver from exercising powers not expressly conferred by the Legislature, yet when a receiver is appointed to carry on the business of a corporation as was done in the instant case, the court thereby makes the receiver the agent of the corporation. The Court must of necessity be bound by the charter provisions. What the receiver does binds the corporation. If the receiver should undertake to exercise powers not conferred upon the corporation, the court of equity on proper application would immediately restrain the doing of such acts.

3.

That The Court Erred In Making a Distinction Between a Public Utility Corporation and a Private Corporation, Indicating That In The Case Of a

Public Utility Corporation a Receiver Would Be Liable For The Corporation Privilege Tax.

We fail to find where any court has made the distinction made by the Circuit Court of Appeals in the instant case, without regard to whether the private corporation was solvent or insolvent and without regard to whether the receiver had been appointed to carry on the business of the corporation or to wind up its affairs.

In Mather's Sons' Co.'s Case, 52 N. J. Eq. 607 (3 Atl. 321), the Supreme Court of New Jersey ruled that the receiver of the private corporation in question should pay the corporate privilege tax which accrued after the receiver was appointed. The court in that case called attention to the provisions of the local corporation act of that state and said:

> "Our corporation act contemplates two classes of insolvent corporations—(1) those of a public character, such as a canal, railroad or turnpike corporation, whose property and work are dependent upon the franchise and in whose continuance the public is interested, and (2) those which are mere private enterprises, incorporated merely to secure the franchise which enables the prosecution of a lawful business, and at the same time protects against individual liability and serves convenience in adjusting changes in the ownership of the capital invested."

The court in that case said that where the receiver was operating a public utility it was his duty to pay the tax. The court also said that in the case of private corporations the receiver should pay the franchise tax when "for any purpose in pursuance of the execution of his trust, he exercises the franchise of the company, and then he should pay as long as he uses the franchise."

The court ordered the receiver to pay the tax, saying:

> "Where the ordinary and usual business of the corporation is continued, as in the present instance, at a profit, in the name of the company, by the receiver, in the hope that the financial difficulties may be adjusted and the assets may be restored to the company, there can be little hesitation in concluding that it is the duty of the receiver to pay the tax while he continues the business."

In the case of Providence Engineering Corp. v. Downey Shipbuilding Corp., 8 Fed (2) 305, the distinction sought to be made between a public utility corporation and a private corporation was denied.

The Supreme Court of Michigan In Re Detroit Properties Corporation, supra, in holding that there was no distinction between a public utility corporation and a private corporation, said:

> "A private corporation obtains its power from the state, as does a public utility corporation, and if the receiver uses the franchise of the corporation when he carries on the business, there is no basis for the distinction claimed."

The distinction made by the Circuit Court of Appeals in the instant case, is not supported by the language of the state statute imposing this tax. The statute imposing this tax makes no distinction between a private corporation and a public utility corporation. Section 4 of the act above referred to imposing this tax expressly excepts "railroad companies and interurban railroad companies, and telephone and telegraph companies, express companies and foreign insurance companies" from the payment of said tax. This exception is made for the reason that the public utility corporations mentioned are

taxed in a special manner as provided by Section 5 of Article X of the Constitution of Michigan. By reason of said exception in the statute imposing said tax, it is clear that the legislature intended to impose said tax upon "all corporations", including certain public utility corporations not expressly excepted from the operation of said statute.

We fail to find any text writer who has made the distinction here claimed by the Circuit Court of Appeals.

Thompson in his work on corporation law, 3rd edition, Volume 4, page 765, states the rule as follows:

> "LIABILITY OF RECEIVER FOR FRANCHISE TAX. The corporation is liable though its property is in the hands of a receiver, or a trustee in bankruptcy conducting the corporation business. It follows that the receiver of a private insolvent incorporation, *continuing its business and using its franchise,* is liable for the franchise tax assessed while continuing the business. But where it is not the duty of the receiver to preserve the franchise and he does not in fact exercise the franchise, it has been held that he will not be obliged to pay any other franchise tax than that which was due at the time of his appointment, unless he realized from the profits of the company more than sufficient to pay its debts and the expenses of the receivership, in which event, before distributing to stockholders, it is his duty to pay all franchise taxes assessed subsequent to his appointment."

The author states the rule which has been followed by the courts in imposing a tax levied upon the privilege of exercising a corporate franchise, namely: BY CONTINUING THE BUSINESS HE EXERCISES THE CORPORATE FRANCHISE, and therefore is liable for the tax.

The reasoning of the Circuit Court of Appeals is that the franchise, the privilege of exercising of which is taxed, is such a franchise as is granted to a public utility. True this is one of the franchises granted, and in the case of a public utility the main franchise, but it is by no means the sole franchise granted and used by a corporation. The statute imposing this tax clearly recognizes that a corporation may possess many franchises, for it provides:

> "It is the intent of this section to impose the tax herein provided for upon *every corporation,* foreign or domestic, having the privilege of exercising CORPORATE FRANCHISES within this state, irrespective of whether any such corporation chooses to actually exercise such privilege during any taxable period."

In addition to the franchise granted to a corporation, namely: the right to engage in business as a corporation, the receiver may take charge of the business of subsidiary corporations whose stock is owned by the corporation of which he has been appointed receiver. Button v. Cities Fuel & Power Co., 300 Fed. 280.

Clark on Receivers, Vol. 1, page 959, states the rule as follows:

> "A distinction may properly be made between payment of a corporation tax imposed on an excise or privilege and a tax on property or upon income merely as income. When receivers proceed to wind up a business, and the former company is prohibited from transacting the business for which it was incorporated and thus deprived of the right to exercise its franchises to do business, then it has been held that such right is not taxable."

In the following cases the privilege tax was ordered paid by the receiver who was operating the business of a private corporation:

Liberty Trust Company v. Gililand, 279 Fed. 432;
Providence Engineering Corporation v. Downey Shipbuilding Corp. 8 Fed. (2nd) 304;
People v. Hopkins, 18 Fed. (2d) 731;
In re Malko Milling and Lighting Co., 32 Fed. (2d) 825.

We do not believe that the distinction made by the Circuit Court of Appeals, between a public utility corporation and a private corporation is sound. If a receiver is appointed to carry on the business of a solvent corporation, and he actually carries on such business, the tax should be paid by him, the same as a receiver who operates a railroad or other public utility.

4.

THAT THE COURT WAS IN ERROR IN QUOTING LANGUAGE TAKEN FROM UNITED STATES V. WHITRIDGE, 231 U. S. 144, IN SUPPORT OF ITS CONTENTION THAT THE RECEIVER WAS NOT LIABLE FOR THE PRIVILEGE TAX.

In the Whitridge case this court was considering a tax imposed upon "income" derived from carrying on a corporate business. It was not a tax required to be paid for the "privilege of exercising a franchise." Because it was an "income" tax, the court found

> "A reference to the language of the act is sufficient to show that it *does not in terms impose a tax upon corporate property or franchises as such,* nor upon the income arising from the conduct of business unless it be carried on by the corporation. Nor does it in terms impose any duty upon the receivers of corporations or of corporate property, with respect

to paying taxes upon the income arising from their management of the corporate assets, or with respect to making any return of such income."

The Michigan statute does impose a tax on CORPORATE FRANCHISES AS SUCH. It imposes the tax upon the privilege of exercising the franchises.

The court further said:

"And we are unable to perceive that such receivers are within the spirit and purpose of the act, any more than they are within its letter. *True, they may hold,* for the time, all the franchises and property of the corporation, excepting its primary franchise of corporate existence. In the present cases, the receivers were authorized and required to manage and operate the railroads, and to discharge the public obligations of the corporations in this behalf. But they did this as officers of the court, and subject to the orders of the court; not as officers of the respective corporations, nor with the advantages that inhere in corporate organization as such. The possession and control of the receivers constituted, on the contrary, an ouster of corporate management and control, with the accompanying advantages and privileges."

and concluded by saying:

"* * * all considerations alike lead to the conclusion that the act of 1909 did not impose a tax upon the income derived from 'the management of corporate property by receivers, under such conditions as are here presented' ".

The court did not believe it was the legislative intention to impose an income tax on a corporation in the hands of a receiver where the corporation was handicapped by reason of the receivership and the statute

there in question was not clear. In this case the corporation was benefited by reason of the appointment of the receiver, and he was required to carry on the business of the corporation.

Because the court in that case said "True, they (receivers) may hold, for the time, all the franchises and property of the corporation, excepting its primary franchise of corporate existence" the tax in question is payable by a receiver under the ruling of the Michigan Supreme Court to the effect that the privilege tax is payable by any corporation ORGANIZED under the laws of Michigan, regardless of whether it exercised its franchises or not.

The Whitridge case was considered by the Circuit Court of Appeals in People v. Hopkins, (1927) 18 Fed. (2d) 731, at which time the court held the receiver liable for the corporation privilege tax imposed under the laws of New York, which statute is nearly identical with the law of Michigan.

The Whitridge case was also before the Michigan Supreme Court In Re Detroit Properties Corporation, supra, and distinguished.

The Whitridge case was also considered by the District Court in the present case and readily distinguished. (R. 17)

It was cited and *distinguished* by the *Supreme* Court of Massachusetts in Collector of Taxes vs. Bay Street Railway, supra.

TAXES IN QUESTION ARE PAYABLE EVEN THOUGH THE RECEIVER DID NOT EXERCISE ANY OF THE CORPORATE FRANCHISES.

If this court should feel some hesitancy in holding, under the facts and circumstances in this case, that the

receiver in carrying on the business of said corporation actually exercised any of the corporate franchises, yet under the statute in question, and the decisions of the Michigan Supreme Court, the taxes in question should be paid by the receiver.

As heretofore stated, the tax in question under the decisions of the Michigan Supreme Court and as enforced in Michigan, is "imposed upon a corporation *organized*" under the laws of Michigan, regardless of whether the corporation does any business within the State. See G. H. Hammond Co., supra.

We call attention to the following report of Hon. William S. Sayres, Jr., Standing Master in Chancery in the United States District Court for the Eastern District of Michigan in the case of Butler Paper Company v. Franklin Press and Offset Company, dated August 21, 1930. In that case the receiver had been appointed to take over the property and assets and to continue the business of the corporation prior to the due date of the annual privilege fee (August 31, 1928). The tax in question in that case accrued subsequent to the appointment of the receiver and the Master held that the receiver was liable for the privilege fee due the State. The Master held that the corporation had not surrendered the privilege of exercising its franchise and that liability for the privilege fee continued during the receivership. Mr. Sayres' opinion is as follows:

> "It will be noted that the applicable language of the statute just quoted requires the payment of this annual fee not by corporations organized *and* doing business under the laws of the State of Michigan, but by 'every corporation organized *or* doing business' under such laws. This language is plain and positive. Its meaning is in no way ambiguous nor doubtful, and that meaning must be given full effect

according to the intention of the legislature thus clearly expressed. This has been recognized by the Michigan Supreme Court which so construed the statute in the case of In re G. H. Hammond Co., 246 Mich. 179, in which it used the following language:

"'It is apparent from the context of the statute itself that this provision was intended to apply to every corporation organized under the laws of this State. Section 4 of the act, in part, reads: 'Every corporation organized or doing business under the laws of this State * * * shall * * * for the privilege of exercising its franchise and of transacting its business within this State pay to the Secretary of State an annual fee,' etc. Michigan has seen fit to adopt legislation by which the annual privilege fee is imposed upon a corporation organized under its laws regardless of whether the corporation does any business within the State. * * *. The Michigan statute provides that every corporation (1) organized, or (2) doing business under the laws of this State shall pay excise tax. The appellant falls under the first subdivision as a corporation 'organized' under the laws of this State.'

"Even if, therefore, there would otherwise be doubt concerning the construction of this statute by this court, such doubt would be removed by that decision of the Michigan Supreme Court."

A tax of this nature was before the Supreme Court of Alabama, in State vs. Bradley (1922), 207 Alabama Reports 677, where the court said:

"The subject of the creator's imposition of this 'franchise tax' is the existence of the corporation, not the 'continued exercise of the corporate franchise.' K. C., M. & B. R. v. Stiles, 242 Ala. 138, 142, 62 South. 734, 735; Id., 242 U. S. 111, 37 Sup. Ct. 58, 61 L. Ed. 176. A domestic corporation not excepted by the Constitution cannot avoid or escape this 'franchise tax' by even complete corporate inactiv-

> ity. The nature and subject of the imposition of this 'franchise tax,' as defined in the Stiles Case, supra, discriminates the case under review from the act of Congress considered in United States v. Whitridge, 231 U. S. 144, 34 Sup. Ct. 24, 58 L. Ed. 159; the act there involved imposing the charge, an excise tax, upon the 'doing of business' by the corporation as measured by a described net income, an exaction materially different from Alabama's 'franchise tax', which, as stated, is imposed upon corporate existence, not corporate activity or exerted corporate function. K. C., M. & B. R. Co. v. Stiles, 182 Ala. 138, 142, 62 South. 734; Id., 242 U. S. 111, 37 Sup. Ct. 58, 61 L. Ed. 176."

Will a court permit a solvent corporation to transfer all its assets to a receiver who carries on the business of the corporation for the mutual benefit of creditors and stockholders, and avoid the payment of a franchise tax—or will the court follow the assets and order the holder therefore to pay the tax?

Clark on Receivers, Vol. 1, page 951 states the rule as follows:

> "Property in the hands of a receiver is in custodia legis, but it is not thereby rendered exempt from the imposition of taxes by the government within whose jurisdiction the property is, and the lien for taxes if any exists by statute is superior to all other liens whatsoever except judicial costs. While a lien for taxes must be recognized and enforced, the orderly administration of justice requires this to be done by and under the sanction of the court."

The payment of taxes is generally classified as a cost of preservation. As a general rule, property in the hands of receivers should bear whatever tax burdens it would be subject to, in the hands of the owner or litigants. McFarland v. Hurley (1923) 286 Fed. 365.

Under the decisions heretofore cited including the decision of this court in the Whitridge case, we contend that in the case at bar the franchises of the Worden Grocer Company passed into the custody of the court upon the appointment of the receiver, who carried on the business of this solvent corporation for a period of upwards of 3½ years and by reason of said premises the court should order the payment of the taxes in question out of any funds in the hands of the receiver before other creditors have been paid in full, in accordance with the order of the district court found in page 19 of the record.

CONSIDERATION OF DECISIONS IN DISTRICT AND CIRCUIT COURTS OF APPEAL.

In Duryea v. American Woodworking Machine Co., 133 Fed. Rep. 329, decided by the District Court of New Jersey in 1904, the court held that a yearly license fee or tax on corporations, which accrued after the receiver was appointed, should be paid by the receiver.

See Davis v. Gray, 16 Wall. 203, 221 (21 L. Ed.) 447, where the court said—

> "A party by going into a national court does not lose any right or appropriate remedy of which he might have availed himself in the state courts of the same locality. The wise policy of the Constitution gives him a choice of tribunals."

In Conklin v. United States Shipbuilding Company, 148 Fed. 129, decided by the New Jersey District Court in 1906, the court held that—

> "The annual franchise tax imposed on corporations by the New Jersey Statute, which provided

> that such tax shall be a preferred debt in case of insolvency, is a valid preferred charge against the assets of an insolvent corporation being administered by a receiver of a court of equity within the State, whether State or Federal, so long as the corporation remains undissolved. * * *"

Coy v. Title Guaranty & Trust Co. (D. C.), 212 Fed. 520, decided in 1914, holds the receiver liable for taxes asessed against personal property while in the hands of a receiver. The court quoted with approval the language of Mr. Chief Justice Fuller, In re Tyler, 149 U. S. 164, 182, 13 Sup. Ct. 785, 790 (37 L. Ed. 689)—

> "Undoubtedly property so situated (in custodia legis) is not thereby rendered exempt from the imposition of taxes by the government within whose jurisdiction the property is, and the lien for taxes is superior to all other liens whatsoever, except judicial costs, when the property is rightfully in the custody of the law, * * *"

In the State of Ohio v. Harris, 229 Fed. Rep. 898, decided by the Circuit Court of Appeals in 1916, the State of Ohio intervened in a receivership case by petition for payment by the receiver of franchise fees exacted by an Ohio statute. The court construed the Ohio law as being a tax upon the actual doing of business, rather than upon the mere privilege of doing; as is the case under the Michigan law. Finding, as a matter of fact, that the receiver had not conducted the business, the petition of the State was denied; but not until the court had added the following significant statement—

> "When we thus treat the interventions alike for purposes of the tax in dispute, we appreciate the fact that we could not do so if the receiver had dur-

ing the tax years in question conducted the corporation business in the regular way; for he then would have been chargeable with having exercised the franchise. Central Trust Company v. New York, 250, 257, 18 N. E. 92, 1 L. R. A. 260, opinion by Judge (later Mr. Justice) Peckham."

Bright et al. v. State of Arkansas, 249 Fed. 950, decided in 1918 by the Circuit Court of Appeals, 8th Circuit, the court held that the receiver of a railroad company should pay an annual privilege tax under a statute which exacted the tax, for the privilege of exercising its franchise. The court calls attention to the decision of the Supreme Court of the United States in United States v. Whitridge, supra, and states that the question of the payment of such taxes by a receiver has long been a subject of debate and of conflicting decisions. The court cites decisions from the Circuit Courts of Appeals, and concludes by saying—

"* * * by the great weight of modern authority, that courts of equity, operating the property and liquidating the debts of corporations which would otherwise have been liable to pay such taxes, ought to direct the payment by their receivers of such taxes as would have accrued during the time the receivers were actually operating the property."

See also the companion of Bright et al. v. State of Arkansas, 249 Fed. 953, which holds in favor of the payment of the tax.

In McFarland v. Harley, 286 Fed. 365, decided in 1923, the Circuit Court of Appeals held the receiver liable for a severance tax accruing after the receiver was appointed. The court held the tax payable, saying—

"They (the receivers) are custodians of the property for the benefit of the litigants, and the property in their hands should bear whatever tax burdens it would be subject to in the hands of the owners or litigants."

In People v. Hopkins, 18 Fed. (2nd) 731, decided in 1927, the Circuit Court of Appeals held that the receiver's custody of property of an insolvent estate, held not to give it immunity from liability for franchise taxes under the tax law of New York, Sections 209, 214; franchise taxes being construed as a tax on the privilege of continued existence as a corporation. The Circuit Court of Appeals then had before it the decision of this Court in the Whitridge case, which is relied upon by the Circuit Court of Appeals in the instant case. The court evidently felt that the Whitridge case was not controlling of the question then before the court, which involved the payment of a corporate privilege tax.

DECISION OF THE CIRCUIT COURT OF APPEALS DEPRIVES THE STATE OF ITS PRIOR LIEN FOR THE PAYMENT OF THIS TAX.

Under the decision of the Supreme Court of Michigan, In Re Detroit Properties Corporation, supra, this tax is payable by the receiver, and under the law of Michigan would be paid by the receiver as an expense of administering the estate. The decision of the Circuit Court of Appeals in the instant case does not give effect to this decision of the Michigan Supreme Court. We submit that the Federal courts should give effect to the rules of priority followed in state courts.

This doctrine was established in New York Trust Co. v. Island Oil & Transit Corp. (1926) 11 Fed. (2d) 699, (C. C. A.—2nd) where the court said:

> "The record suggests two questions; strictly speaking the order appealed from answered neither. They are: (1) Is the state of Virginia entitled to the tax as matter of law? (2) Is it expedient to pay the tax as an expense of administration? The order merely "authorized" the receivers to pay the tax; it affords no information as to why authorization was given.
>
> "(1). From the memorandum filed below, we are inclined to think that the learned judge considered it fair, or prudent, or 'equitable' to have the tax paid; he did not hold any legal duty to pay lay on the receivers.
>
> "If these receivers had been appointed by a national court sitting in Virginia, if the assets were in that state, and it had demanded as of right preferential payment of this tax, payment would have been due, if the law of Virginia so held. *The priority demanded would have been 'enforceable against the property in the hands of a receiver appointed by a federal court within the state.'* Marshall v. New York, 254 U. S. 380, at page 385, 41 S. Ct. 143, 145 (65 L. Ed. 315)."
>
> "The property in the hands of these receivers is 'equitably' creditors' money; it is only to be diminished before payment to creditors by legitimate and reasonably necessary expenses."

CONCLUSION.

In conclusion we submit that the Circuit Court of Appeals erred in its decision holding that the taxes in question should only be paid in case a surplus over indebtedness was payable by the receiver to stockholders, for and

on account of their stockholdings, and that the State may share in the distribution of assets only if and after other creditors and the expenses of the receivership are paid in full.

We submit that the order (R. 21) of the district court requiring the receiver to pay the taxes in question should be affirmed and that the decision of the Circuit Court of Appeals insofar as it conflicts with the decision of the District Court be reversed with costs to your petitioner.

Respectfully submitted,
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